

# The Role of Choice in the Legal Regulation of Consumer Markets: A Law and Economic Analysis

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### *Abstract\**

*The paper explores the various meanings of choice in consumer contracts, and the increasing importance and availability in consumer contracts of choosing among different laws and legal frameworks for the transaction. This has become particularly relevant with proposals concerning optional regimes to govern consumer contracts, most notably the Common European Sales Law (CESL). We analyze critically the positions of different commentators regarding the undesirability and futility of a choice of legal regime for consumer contracts such as the one provided by CESL. We also address the views that encourage an expansion of choice of law in consumer contracts, allowing more (or even full) horizontal competition among legal systems in this area. We present economic arguments that recommend caution before a major expansion, and support the use of minimum quality standards in this area. We end with a proposal that, departing from art. 6 of Rome I Regulation, would expand choice of law and through it perhaps savings in firms' costs, but that preserves at the same time the expectations of consumers.*

*El trabajo analiza los distintos significados de la noción de elección en los contratos con consumidores, así como la importancia creciente en este campo de la posible elección del Derecho aplicable. Esto obedece en parte a las propuestas de regímenes optativos u opcionales para regir contratos de consumo, como el Derecho común europeo de la compraventa (CESL). Revisamos críticamente las posiciones teóricas que se han expresado acerca de los efectos negativos y de la futilidad de introducir regímenes optativos en los contratos de consumo, como CESL. Examinamos igualmente las posturas favorables a una expansión de las posibilidades de elección de ley aplicable en el ámbito de consumo a fin de ampliar la competencia horizontal entre ordenamientos. Presentamos un catálogo de argumentos económicos que aconsejan suma cautela antes de proceder a tal expansión, y en apoyo de la existencia de estándares mínimos de calidad de los derechos de los consumidores en este ámbito. Concluimos con una propuesta que, sobre la base del art. 6 del Reglamento Roma I, permite expandir la posibilidad de opción y, con ello, tal vez reducir costes a las empresas, pero a la vez sin apartarse de las expectativas de los consumidores.*

*Título:* El papel de la opción en el régimen jurídico de los mercados de consumo: un examen desde el análisis económico del Derecho

*Keywords:* Choice of Law, Consumer Contracts, European Contract Law, Law and Economics

*Palabras clave:* Elección de ley aplicable, contratos con consumidores, Derecho europeo de contratos, análisis económico del Derecho

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## 1. Introduction

If one would have raised the term “choice” associated with Consumer Contract Law in Europe twenty, and perhaps even ten years ago, the likely reactions among legal academics would have mostly been of incredulity and skepticism, even of rejection. Choice was limited to product, brand and vendor (when variety was available), but the rest was imposition under the shadow of the applicable laws and regulations governing the transaction. Asymmetries in bargaining power and information, the widespread use of standard terms and standardized contracting protocols, even before the diffusion outside of a very limited circle of psychologists and experimental economists of the prevalence of not-so-rational biases and heuristics in consumer behaviour would have suggested that an inquiry about choice in consumer contracting would essentially be a fruitless, almost objectless endeavor.

When one considers the present state of the legal debate in Europe, the issue of choice in consumer contracting is experiencing a sizable surge in interest, perhaps specially after the publication by the Commission on 11 October 2011 of the [Proposal for a Regulation on a Common European Sales Law](#) (CESL),<sup>1</sup> a text that, as is well known, has been launched in the Proposal as an optional instrument for European firms and consumers. Choice in Contract Law, including consumer contracts, has become a focal point for theoretical and policy debate on contracting. Notice that the emphasis is now placed on choice of laws and legal rules, what was formerly the relatively narrow and technical realm of Conflict of Laws scholarship. Now, it is at the forefront of Private Law policy in Europe.

In this essay we do not cover all issues of choice surrounding optional sets of Contract Law rules such as CESL, and at the same time we do not intend to limit the reach of some of our ideas to CESL. But we do intend to explore several issues concerning choice of legal rules in settings of contracts between firms and consumers, as being revealed by the debate following the publication of CESL.

We frame our contribution along two different, albeit related, lines. One is -sorry for the lack of modesty- our own previous work on legal harmonization and European Contract Law. In a first wave of papers we analyzed how efficiency-minded lawmakers should set legal standards in settings of pre-existing divergent legal systems and where building markets across national borders can be expected to produce social welfare gains.<sup>2</sup> The second wave addressed more directly optional sets of legal rules governing contractual interactions, and tried to provide an stylized model of firm’s choice when confronted with optional European rules and diverse national rules.<sup>3</sup> Now we introduce a broader set of economic arguments concerning Law and choice in consumer contracts.

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<sup>1</sup> COM (2011) 635 final.

<sup>2</sup> See GOMEZ and GANUZA (2011a), (2011b), (2012).

<sup>3</sup> GOMEZ and GANUZA (2013a), (2013b), (2013c).

This essay is also part of the ongoing policy debate about European Contract Law and the desirable strategies for the European lawmakers (at the EU and the national levels) to use Contract Law in a purposeful and productive way to promote social welfare.

The article will be organized as follows: in Section II we present the issue of choice in consumer contracting. In Section III we address the view that optional sets of rules would produce choice only for the wrong (having consumers' welfare in mind) reasons. Section IV refers to the effectiveness of choice in the presence of optional rules, focusing on the behaviour of the firm. Section V analyzes the claims of insufficient (firm) choice in the present legal framework of consumer contracts in Europe, and present economic arguments to undermine the soundness of those claims. Section VI briefly concludes.

## *2. Introduction: dimensions of choice in consumer contracting*

When economists (as well as consumers themselves, but also firms and marketers) think of consumer choice, they mostly entertain views of the large variety of options consumers face as to products, services, quality levels, add-ons, brands, and so on<sup>4</sup>. This was, and still is, true in the well-stocked, bricks-and-mortar shopping environment of affluent countries at least in the past several decades. This is even more so in the virtual environment of electronic commerce in more recent years, where geography and distance place no boundaries to consumers as to the number and location of vendors, and thus variety is vast, almost limitless. Private lawyers, in turn, although aware of the above dimension of consumer choice, both for conscious and for inadvertent (perhaps due to professional and intellectual bias) tend to make their notion of choice gravitate more towards alternative contracts, alternative contract terms and, more recently, as we will discuss, different contract laws.

Not that the two dimensions are separate, that the material and economic world, on the one hand, and the legal world, do not penetrate each other. Obviously, consumer choice of the first kind takes place in settings heavily relying on legal infrastructure -mostly beyond Contract Law in the narrow sense- and is channeled through mechanisms that are deeply influenced by Contract Law rules. Moreover, contract terms and contractual solutions, both designed by the parties or determined by the Law, become features of the good or service, become "a thing" that the buyer gets in return of the price and has important effects on the expected and actual utility derived from the "consumption" of the product. That is, product and contract are not distinct entities, but are intertwined in a single mix of outcomes for the buyer in the future states of the world. There is no clear gap between object and term, between materiality and textuality, if one prefers<sup>5</sup>. Referring to standard form contracts, Lewis Kornhauser frames it this way: "(...)

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<sup>4</sup> This dimension of choice is obviously crucial for marketing research, consumer research, and consumer psychology, in addition to economics. For a summary of consumer choice research, BABUTSIDZE (2011).

<sup>5</sup> This has long been observed in the legal literature: LEFF (1970, p. 155); RADIN (2000), (2012).

regarding the standard form not as a contract, but as a thing like an automobile, a carpet, or a new drug”<sup>6</sup>.

Choosing among contract formats and contract terms has been for centuries part and parcel of contractual consent and freedom of contract, both notions lying at the core of Contract Law and contract doctrine across legal traditions and national boundaries. The liberal theory of contract - and probably even earlier theories in the early Modern Era, the Middle Ages and late Roman times- was grounded on the model of voluntary exchange between free and knowledgeable individuals.

Choices underlying contracting have been, and continue to be made in the context of a specified legal system, which provides the legal framework for legal formats to emerge and achieve market acceptance, and for legal terms to be created, assessed, introduced, and eventually implied into a given contract. Both Contract Law theorists and practitioners have been fully aware that the legal system of reference for a certain contract, at least in many cases, is not exogenously determined, but in itself a product of choice by the parties: Contract formats and contract terms are designed, selected, chosen, and eventually bargained for against the background of a Law that is not God-given, but chosen by the contract parties. This latter choice, however, has largely been considered the province of Conflict of Laws, a separate legal discipline not always fully integrated within general Contract Law theory and practice.

In the consumer context, it has been a while since the idea of consumer choice in the “legal” meaning of the notion has widely enjoyed good reputation. Asymmetries of bargaining power between firms and consumers, consumer lack of information, experience and expertise, and the pervasive use of standard forms and terms in B2C contracting have made many contract theorists blink at the mention of consumer’s true consent in consumer contracts, let alone genuine choice<sup>7</sup>. Consent as to contract terms in consumer interactions is considered to be a conceptual relict of the past. In an apt formulation, it is not even vestigial, it is purely fictional<sup>8</sup>. When terms are nowhere to be seen and read, when terms are screens away on the web, and when almost unanimously consumers sheepishly click the ready onscreen boxes declaring agreement to terms one does not know about, let alone read and understood, to think about choice in consumer contracts appears to be absolutely misguided.

There is evidence of various sorts that consumers, in e-transactions and in other forms of contracting relying on standard form terms governing the contract, do not commonly read the contract terms before entering into the contract, do not have the capacity, or the willingness, to read and understand the implications of standard contract terms, and do not value the opportunity to read the terms prior to contract, nor they value typically the more advantageous

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<sup>6</sup> KORNHAUSER (1976).

<sup>7</sup> Again, an old and distinguished literature has identified and elaborated on the death of consent in contracting in mass consumer markets: RAISER (1935); RAKOFF (1983). For more recent views, CAFAGGI and MICKLITZ (2009).

<sup>8</sup> RADIN (2007). The argument is elaborated upon further in RADIN (2012).

contract terms they may hypothetically be able to find if they read standard contract terms in advance and shop around for more favorable ones.<sup>9</sup>

Moreover, there is also evidence that the opportunity to read the standard terms before signing the contract does not change the substantive content of the contract terms, as the rights and obligations of consumers go: an empirical analysis of more than 500 types of contracts –online software transactions– does not show that the standard terms that were not made available to the consumer prior to the transaction, but sent together with the good to the consumer after the contract was binding were any worse, in terms of consumer friendliness across all dimensions of the transaction, than the standard terms that were made available to the consumers prior to the purchase decision.<sup>10</sup> It is the size of the firm and the number of years the seller has been in operation what seem to drive the main influences upon the quality of the standard terms.<sup>11</sup>

Thus, the available empirical evidence does not seem to give a clear indication that imposing duties to disclose standard contract terms and providing consumers with opportunities to read them actually improve the material situation of consumers in terms of the welfare they obtain from the transaction.<sup>12</sup>

Even sharing this initial assessment of the problem, potential solutions diverge. Some try to revitalize consent through various means.<sup>13</sup> Others adopt a very skeptical view about the ability

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<sup>9</sup> See, for a summary of evidence of consumers not reading the terms, HILLMAN and RACHLINSKI (2002). For an excellent discussion of the factors that make reading the standard terms an unattractive –and hopeless– course of action for consumers, see BEN-SHAHAR (2009).

On the potential valuation of consumers of the opportunity to read and of favourable terms in the set of standard terms, using a large sample of real-world contracts (End User License Agreements in online transactions on software products), it has been found that the absence of presumptively unfavourable –for the consumer, that is, pro-seller– choice of Law and choice of forum clauses does not affect the price consumers pay for the goods: MAROTTA-WURGLER (2007). Additionally, this study does not reveal any statistically significant difference between consumers and business buyers of the same software goods. Using the same database of online software contracts, and after constructing a comprehensive index of the “quality” in terms of consumer friendliness of the set of standard terms (covering aspects as the acceptance of the license, the scope of the license, the transfer of the license, warranties and warranty disclaimers, limitations of liabilities, maintenance and support, and conflict resolution) it has been found that there is no evidence that consumers of a given type of product are willing to pay higher prices in order to get more favourable contract terms of a standard nature: MAROTTA-WURGLER (2008). As with the study previously cited on dispute resolution clauses, a third related study [MAROTTA-WURGLER (2009)] shows no perceptible difference in the overall buyer-friendliness of the terms between consumer and business buyers, nor between products typically oriented to consumers and more business-like types of products.

<sup>10</sup> See MAROTTA-WURGLER (2009).

<sup>11</sup> See MAROTTA-WURGLER (2009). The market structure (whether there is less or more competition in the relevant product market does not seem to play a role either in the forces leading to more or less consumer-friendliness of the standard terms: MAROTTA-WURGLER (2008).

<sup>12</sup> Some even argue that concentrating effort on disclosure duties may actually be harmful for consumers, if these “procedural” sorts of protections associated with the opportunity to read are negatively correlated with the willingness of Courts to strike down individual clauses –and not the entire set of standard terms– for substantive reasons, or adopt more effective means to prevent those clauses that are actually detrimental to consumer welfare: BEN-SHAHAR (2009).

<sup>13</sup> HILLMAN (2007) (disclosure as a possible remedy); BOARDMAN (2007) (contract interpretation rules as a remedy); LOW (2013) (although emphasizing the problem of choice overload, pointing at increasing familiarity with the

of Contract Law, or Law more generally, to significantly and positively change consumer's apathy as to reading contract terms and choosing on the basis of their information about those terms<sup>14</sup>.

The possible adoption of optional sets of rules to govern consumer transactions adds a new dimension to the choice problem. The focus, given the optional Law dimension, shifts to choosing among laws and legal regimes rather than contract terms, let alone products and vendors. This doesn't imply that the choice contract terms ceases to be important,<sup>15</sup> but a new dimension opens up which may not only affect directly the admissibility and enforceability of certain standard terms, but many other legal elements that shape the outcome of the transaction. Thus, what formerly was a distinctive feature of international trade transactions between firms would seem to be fair game for thinking about consumer markets and contracts. Not that issues that have been discussed above concerning terms as parts of the "product", or informational and reading costs in consumer transactions cease to be relevant in this new and slightly different scenario. Much of that also applies to "laws" that can be chosen to govern the contract. But there are also some new and distinctive elements in the setting that deserve ad hoc analysis. Moreover, in policy terms, the alternatives, constraints and views experience significant changes from the more established setting of alternative contract formats and contract terms. Some of those new elements will be addressed in the following sections.

### *3. Can choice in consumer contracts be only excessive and undesirable?*

The strong European interest about Law and choice in contracting, including consumer contracting, is obviously not merely a product of the CESL initiative or the European Commission's ambitions in terms of harmonization policies in Private Law. As will be discussed below, these developments found fertile ground for debating Law and choice after the reception by a substantial group of European Private Law scholars of the relevance of Law as a product

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domain of choice, prompting previous preferences about the content of future choices, the existence of salient or dominant options, and increased differentiation of options as potential strategies to improve choice); CHE and CHOI (2009) (restricting the number of potential terms, where reading costs are not too high, may lead firms to offer good quality terms that consumers will read with positive probability, which implies forgone sales if firms try to cheat by offering bad quality terms); GILO and PORAT (2010) (considering that under certain circumstances competitors of a given firm may have incentives to educate consumers about unfair or undesirable terms used by the incumbent firm selling to consumers).

Others propose solutions that, while improving the outcome in consumer contracting in the presence of information and reading costs for consumers, do not imply actual "informed consent" by consumers, meaning that consumers will actually read and be aware of the content of contract terms. Standardization, coupled with a certain upper limit to consumers' costs of reading terms may lead to an efficient allocation of contract types (depending on their terms) to consumer types, and consumer "reading and actually consenting" is an off-the-equilibrium threat that makes firms offer the right terms within the standardized set: WICKELGREN (2011).

<sup>14</sup> KATZ (1990); BEN-SHAHAR (2009); BEN-SHAHAR and SCHNEIDER (2011); AYRES and SCHWARTZ (2013, p. 17).

<sup>15</sup> As emphasized by COLLINS (2013).

offered by market participants in the legal market and where competitive forces may be at work to shape the content and prevalence of Private Law rules<sup>16</sup>.

With respect to consumer contracts, there are several views that strongly criticize the excessive and undesirable room for choice (by the firm, not the consumer) of legal regime that optional instruments such as CESL promote. Some commentators argue that the choice left to firms by an optional set of rules governing the consumer contract is just an instrument of social dumping. Firms will impose the optional set of rules to consumers for one a single bad motive: to get rid of high levels of mandatory consumer protection that the firms would otherwise be legally required to comply with under the national Contract Laws. Thus, firms would only choose an optional law such as CESL if one condition is satisfied, namely that the substantive rules undercut the level of consumer protection provided by the other legal orders -those of national states- that are the alternatives to the choice of legal rules offered to the firms selling to consumers.<sup>17</sup>

We have already shown formally that this social dumping condition for the choice of an alternative, optional, Contract Law (CESL or some other body of rules) is theoretically unsound.<sup>18</sup> Firms selling to consumers may be voluntarily choose an optional set of rules, depending on the level of consumer protection embodied in the rules (and the costs that the provision of such protection entails for firms), if the savings in the costs of verifying compliance with a given level of consumer protection, and in the costs of doing business under more than one applicable set of rules (legal diversity costs). Depending on how those cost functions are, given the level of the relevant standards (national and/or European), we show that firms may end up operating solely with the European set of rules, or with the European standard in one market and with the national standard in the other market.

Notice that the argument is independent of factors influencing why certain contract terms or certain laws may become “sticky” (that is, terms that remain widely adopted in practice despite their having lost appeal for many users), or that new terms or laws are adopted too quickly, given the majority preferences of users. Network externalities are often, and rightly, viewed as reasons behind the common observation that many firms -and perhaps other legal actors different from firms- use the same set of laws, or the same contract terms: a certain product -including a legal rule or a contract term- becomes more valuable to users as the number of users of the same product increases.<sup>19</sup> The causes underlying why this positive network effect is

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<sup>16</sup> The ideas of Law as a product, and of the existence of competition among lawmakers to provide legal rules that users, directly or indirectly, buy, originate in the US Corporate Law scholarship, adapting pre-existing economic ideas of regulatory competition in the provision of local public goods: ROMANO (1985). They have been extended to other areas of the legal system, including contracts [O'HARA and RIBSTEIN (2009)] and imported into the European Private Law set of theoretical and empirical debates: GRUNDMANN (2009); EIDENMÜLLER (2009), (2011), (2013a).

<sup>17</sup> See COLLINS (2008, p. 74); LURGER (2007); RUTGERS (2006), (2011); SEFTON-GREEN (2011).

<sup>18</sup> GANUZA and GOMEZ (2013b), (2013c).

<sup>19</sup> Network externality is a notion that appeared in economics to characterize some properties of network goods (communication and information goods, mostly), and later on it was adapted to the legal sphere, initially in the

present in a particular setting or with respect to a particular product may be manifold: learning, increased presence of complementary goods, liquidity and tradeability facilitated by the ability to price something that is “standard” and not idiosyncratic, etc.

Negative signaling is also a factor explaining why a firm may decide to resort to the most familiar or widely used contract term or set of laws (be they the traditional ones, or new ones that have suddenly become trendy in the market) even if they are not the ones that best suit its preferences or would maximize the joint surplus from a given contract, be it with consumers or with business parties. If the counterparties may find strange that the familiar term or law is not used, they may suspect that the firm’s decisions to deviate from the standard contract term or law, and to choose an alternative one, is suggesting some unknown and undisclosed problem with the contract or with the firm offering the unfamiliar alternative.<sup>20</sup> Of course, in a perfect and symmetric information interaction, such considerations of negative signaling play no role, but when parties do not know everything about each other, and important information is not known to the counterparty, these negative inferences that may be drawn by unfamiliar choices may explain why some parties with ability to choose terms or laws prefer not to arouse suspicions of any kind and simply reassure counterparties by conforming to what most other parties do. Although this logic has been specially applied to debt relationships, it may be present in the setting of firms suggesting terms to consumers (of course, terms referring to elements of the transaction that consumers are familiar or experienced with) or optional sets of rules. Contrary to network externalities, it is not correlation of valuations by different users what drives the logic of the argument, but asymmetric information and adverse selection considerations. As with network externalities, the outcome is conformity with the standard, be it an old or a recent one. Thus, network externalities and negative signaling may reinforce the force of verification and legal diversity costs in moving firms to choose a new, optional set of rules. Of course, whether this will actually happen is very hard to predict and estimating the frequencies would require significant amount of information about real world data underlying the magnitude of those effects.

However, the somewhat dismal forecast that firms will only choose a new set of optional rules when this is bad for consumers’ welfare is not at all warranted in theoretical terms. For a wide range of values of the relevant parameters, the exercise of choice of optional rules by firms in consumer contract settings can (but only “can”) be beneficial, or at least not detrimental, to consumers.<sup>21</sup>

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corporate contract setting; KLAUSNER (1995); KAHAN and KLAUSNER (1997). In a broader contract context, see GULATI and SCOTT (2013, p. 34); ENGERT (2013).

<sup>20</sup> BEN-SHAHAR and POTTOW (2006); GULATI and SCOTT (2013, p. 35).

<sup>21</sup> GANUZA and GOMEZ (2013b), (2013c).

#### *4. Is choice of legal regime in consumer contracting doomed to be ineffective?*

There are several strands of the literature focusing on the effectiveness of choice before optional sets of rules governing consumer contracts. A group of contributions focus on the consumer's actual choice possibilities, and shares with the social dumping literature a critical stance towards optional rules governing consumer transactions. This literature essentially challenges the idea that the optionality of rules does not involve in any meaningful way any kind of choice or option for consumers. These views emphasize that it is always the strong party, the firm, the one who would unilaterally, and based upon its egoistic and one-sided calculation of costs and benefits, decide and impose on the other party whether to choose, or to waive, a given optional set of governing rules. Consumers would be left, at best, and depending on the nature of the goods and services, and on the market structure, with the option to contract under the rules chosen by the firm, or not to contract at all.<sup>22</sup> The criticism, in some cases, goes beyond the lack of genuine enhanced consumer choice, and point to an actual net deprivation of consumers' choice opportunities: Given that consumers are not aware of the full range of alternatives and the consequences of contracting under one or the other set of rules, they may even experience some restriction in the chances to look for another vendor of the same or a similar good or service under the laws of his or her home country.<sup>23</sup>

A second group of approaches to the effectiveness of choice of legal rules governing the transaction under optional instruments essentially consider that firms would not consider worthwhile the additional costs of choice regarding new optional sets of rules, given that they substantially enjoy more than enough scope for choice under the traditional area of Conflicts of Laws rules and doctrines.<sup>24</sup> The list of arguments marshaled in favour of this view is a long one. First, legal disparities and divergences are not an important factor behind consumers' decisions to enter into transactions with foreign firms, and search and negotiating costs are, so it is argued, essentially invariant with respect to legal factors. Thus, the harmonization advantage of trans- or supra-national optional laws would become moot. Second, inertia, status-quo biases and endowment effects would make new optional sets of legal rules powerless in order to mobilize firms and consumers to abandon the legal rules they are currently using to govern their economic transactions. Third, many firms are happy with their national legal framework, and even if they would seek some alternatives, they would naturally go to legal rules of similar legal traditions and/or neighbouring jurisdictions. Fourth, additional sets of rules of an optional character would produce for firms, let alone consumers, problems of choice overload, which, moreover, would be aggravated by the complex and novel character of newly drafted optional sets of rules.

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<sup>22</sup> See CARTWRIGHT (2011); HOWELLS (2011); TWIGG-FLESNER (2011); DORALT (2011, p. 8); LOOS (2011).

<sup>23</sup> CARTWRIGHT (2011).

<sup>24</sup> See LOW (2010), (2012), (2013). To some extent, SMITS (2013), shares a somewhat skeptical view about the value of optional laws (or, at least, of CESL) to meaningfully enlarge the choice set of firms already operating in consumer markets.

The third group has a different outlook and aim. It essentially tries to underline the importance of scope of legal rules for inducing increased levels of choice of legal rules, or addresses the technical side of choice in order to make it safer, smoother and eventually more appealing.<sup>25</sup> Although this literature it may be critical, even very critical, with scope and choice of law solutions adopted in CESL, and that perhaps may be copied in other future optional sets of laws, as a whole it tends to consider that choice of rules is both meaningful and important for consumer contracting, and thus tries to suggest ways to improve the process of opting into a set of a rules that will govern a consumer transaction. We will not address this strand of the literature here, since it does not seem, in our view, to pose a challenge to the way in which we approach choice of rules in the consumer setting.

As to the two previous strands of the literature, the one focusing on consumer choice failure or even deprivation largely rests upon two theoretical claims -or assumptions, as they often remain implicit. First, that there cannot be an optional set of rules that is attractive for firms to choose, while ensuring a high degree of consumer rights for consumers in the contract. Second, that firms will never willingly operate under more than one set of rules, and thus, unless forced to do it, would always refuse to offer consumers the choice of transacting under one or the other.

As we showed formally in previous work,<sup>26</sup> none of those two claims is theoretically correct. It is possible to show that there are conditions in which the following two propositions may be satisfied at the same time: Optional rules for consumer contracts that firms will find attractive to choose in their contracts have levels of consumer protection that are higher than the alternative sets of rules, most notably those of pre-existing laws, or laws of other jurisdictions; second, that firms may offer a choice of the applicable set of rules to consumers, so that different sets of rules may coexist, and be offered alongside, national laws.

Thus, the fact that the basic decision to choose the governing set of rules would most likely go to the firm -as a consequence of it being a repeat and more experienced player, of typically possessing higher knowledge of the legal alternatives, and more importantly, because it is for the firm to decide which consumers and markets it is interested in serving- does not mean that consumers will never have a choice and, even less, that they will be deprived of choices they now enjoy.

Let's now briefly turn to choice of legal rules not being effective because firms will not consider worthwhile to have an optional set of rules, additional to the possibilities (wide or narrow, is a matter of taste, for many) they now enjoy under traditional Conflicts of Laws principles. It is true that one has to be cautious concerning overoptimistic claims about firms benefitting from choice as to legal rules governing consumer transactions (both under general Private International Law Principles and under newer optional laws approaches).<sup>27</sup>

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<sup>25</sup> DORALT (2011, p. 13); RÜHL (2012); WHITTAKER (2011); BASEDOW (2012); DANNEHMANN (2013).

<sup>26</sup> GANUZA and GOMEZ (2013b), (2013c).

<sup>27</sup> See how an empirical approach using the own Eurobarometer survey data, places in perspective the European

The level of actual use of the CESL would most definitely constitute the object of an empirical prediction and not a theoretical result, and we do not have data on which to make such a prediction. We conjecture, however, that complete autarky is unlikely to be the equilibrium outcome. When one combines the efficiency gains of lower production costs by some firms who may be able to enter other European national markets more easily, with the savings in verification and legal diversity costs, it seems that there is at least room for a sizable number of firms deciding to take advantage of the increased possibilities offered by optional laws. In fact, there are precedents in the European context of optional regimes that successfully co-exist with national laws, when the European rules, even if more exacting than many, if not all, pre-existing national ones, allow firms to save legal costs.

Moreover, for the firms who are currently active in cross-border trade with consumers, trans-national optional sets of rules may be particularly attractive, and they may be very willing to exit the “national legal systems” framework for such transactions. If a sufficient mass of such firms choose the optional rules, it is likely that network externalities and negative signaling, for the reasons explained in the previous section, may provide an added push to the more reluctant participants in those markets.

### *5. The alleged insufficiency of firm choice in consumer contracts*

In this section we will basically analyze with Law and Economics arguments the positions of those who consider that even with optional sets of rules such as CESL, the European legal framework still does not go far enough to allow firms to choose the legal regime that best suits their needs for serving consumers. That is, firms should enjoy unlimited (or at least expanded) choice of legal regime for consumer contracts, and thus be able to subject the contract to the national (or supra-national) legal regime they see fit.

The basis for these positions, that will be explained more in detail below, is, unsurprisingly, the regulatory competition model. This model implies that, at least in some areas of the Law (Corporate Law was the original area, and now Contract Law and others have been added<sup>28</sup>) competition among jurisdictions will force them to improve the quality of the legal rules to satisfy the preferences of the “consumers” or “buyers” of legal rules –companies, in the case of Corporate Law; contract parties in the case of Contract Law. In their drive to attract customers, the “sellers” –the jurisdictions- will be under the competitive pressure to adopt rules that provide maximum benefits to the customers of the legal system. Like in other markets, also in the market for legal rules, product quality would in the end be optimal.<sup>29</sup> Not only competition would

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Commission’s overselling of CESL: HUBBARD (2013).

<sup>28</sup> O’HARA and RIBSTEIN (2008); EIDENMÜLLER (2013a).

<sup>29</sup> This view of the Corporate Law market has been –and still is– very influential in the US, and so is in Europe: EASTERBROOK and FISCHER (1982); ROMANO (1985). In Europe, EIDENMÜLLER (2011). Many do not share the idea

provide a forceful engine towards finding the legal solution that maximizes the satisfaction of legal customers, if the preferences of the customers are typically not significantly heterogeneous (as those of firms may be: they seek profit maximization) the satisfaction-maximizing legal response would be essentially similar across jurisdictions, thus leading to a sort of competitively harmonized legal regime: Given that the efficient solution would be -roughly- the same for all jurisdictions, being the relevant preferences quite similar, the competitive process would push all jurisdictions to choose the uniquely efficient legal regime.

As is well-known, Art. 6. 1 and 2 of Rome I Regulation, for most consumer transactions (not when the consumer is physically shopping abroad, or is actively seeking transactions in a foreign country, since then the principle of freedom of choice prevails<sup>30</sup>) choice of legal regime is significantly constrained, since it is not allowed that choice of law clauses deprive consumers of the level of protection provided by the mandatory rules of the legal system of the country in which the consumer has his or her habitual residence.

A number of influential European legal commentators argue,<sup>31</sup> with slightly different emphasis, but substantial agreement as to the core of the basic criticism and the essence of the solution, that would be welcome to significantly expand choice of legal rules in consumer contracts. The current preferential treatment in favour of the legal regime of the consumer's home country should be abandoned in order to foster fuller horizontal competition of legal systems, at least of those of the EU Member States. The present regulatory regime under Art. 6.2 Rome I Regulation prevents "*any meaningful legislative competition at the horizontal level between States, as the consumer's domestic law will always prevail unless foreign law offers a higher standard of protection*".<sup>32</sup> As arguably the constraints set by Rome I Regulation do not apply to the choice of CESL as set of rules governing the consumer contract, there is unequal treatment of EU Law (CESL) and national law (the different laws of the EU Member States, and also of the other countries in the world) and

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that such a competitive market exists in Corporate Law, at least in a recognizable form: KAHAN and KAMAR (2002); ROE (2003); BAR-GILL, BARZUZA and BEBCHUK (2006); GOMEZ and SAEZ (2006).

In Contract Law, the faith in regulatory competition seems to have both believers and non-believers in Europe. As to the first, EIDENMÜLLER (2013a); RÜHL (2013). Among the second, the meta-study by VOGENAUER (2013).

<sup>30</sup> Art. 6.4 Rome I Regulation provides for other exceptions to the application of 6.1 and 6.2. For an analysis of the entire Art. 6 Rome I Regulation, RAGNO (2009). Though most commentators have not taken issue with it, some have pointed out the inconsistency of limiting consumer protection from the consequences of unlimited choice of law only for "passive" consumers, and not to those who physically or virtually shop abroad in an active way. They advocate the use of the mandatory laws of the place where the firm does business, in a similar way as Art. 6.2 Rome I Regulation employs the mandatory laws of the consumer's habitual residence. See GARCIMARTÍN ALFÉREZ (2012).

<sup>31</sup> See ACKERMANN (2013); EIDENMÜLLER (2013b); GRUNDMANN (2013). RÜHL (2011) considers that the choice of law model underlying Art. 6.2 Rome I Regulation is an economically viable compromise between ensuring sufficient choice and ensuring adequate consumer protection. However, in RÜHL (2013), the author advocates the elimination of the restrictions in Arts. 5 (contracts of carriage) and 7 (insurance contracts) Rome I Regulation. True, the way in which those two provisions constrain choice of legal regime is not the same as in Art. 6.2, but the reason for criticizing the other two provisions is squarely the expansion of freedom of choice as a condition for regulatory completion.

<sup>32</sup> ACKERMANN (2013).

thus the process of regulatory competition becomes fundamentally distorted to the advantage of EU Law. The natural remedy would then be to eliminate the distortion tilting the outcome in favour of CESL and EU Law, by exempting also the choice of the legal rules of the different countries from the unduly discriminatory -against national legal orders- constraints determined by Art. 6.2 Rome I Regulation. This would imply unconstrained, or at least greatly expanded, ability of contract parties to a consumer contract to choose the governing law, regardless of whether the chosen set of rules satisfies the level of mandatory protection of the consumer's home country legal system.

There are several and important reasons why we do not share these views, and we will present them in the following pages. It is however important to remark from the outset that the focus on undistorted and fair competition between EU Law and national legal orders is a misguided basis to understand and evaluate the consequences of enlarging or restricting choice of legal orders in consumer contracts. Obviously, "distorted" and "unfair" are terms with immediate negative connotations, and thus raise almost automatic rejection: How can something "distorted" or "unfair" be good? Competition, however, is not a value in itself, it is merely a tool (often, a very useful and powerful one) to achieve the outcomes that better serve society's goals. In economics, competition is not valued for its own sake, and having "nondistorted" competition is not something prized as an ultimate goal. Competition is desirable when the allocation it produces is superior in terms of social welfare to those under alternative mechanisms. This is something, as standard elementary microeconomics teaches, that is often true concerning the allocation of private goods. But it is not always and necessarily true. And it is not actually the case that we always prefer full, undistorted competition to "less" or "distorted" competition. Sometimes less competitive mechanisms produce better allocations than more competitive or less distorted ones.<sup>33</sup> Our choice should be based (at least for economists, who are, at heart, consequentialists as to decision rules) on the outcomes, not on the characteristics of the process. This means that appeals to the "distortions" of regulatory competition are by themselves largely uninformative about the desirability of a certain regulatory environment. It is the consequences of the distortions -and of the removal of the alleged distortions- that matter.

We will not fully review the theoretical and empirical contributions on the regulatory debate, not even those that refer more specifically to Contract Law. But we will mention a few points that should make us somewhat more skeptical about observing true regulatory competition in the real world.

First, the theoretical assumptions that underlie the result of efficient regulatory competition, both in the initial model of mobility of individuals<sup>34</sup> and in the model of mobility of capital<sup>35</sup> are

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<sup>33</sup> A well-known (since the French economist and mathematician Cournot found out in 1838) illustration is that of the provision of pure complementary goods, where perfect competition between producers of each good generates worse results than less competitive mechanisms, in fact, worse than monopoly. It is thus not surprising that introducing distortions in a competitive mechanism may lead to better results than under undistorted competition: See, for an application to public procurement of how less competition may enhance welfare under very plausible conditions, GANUZA and GOMEZ (2013a).

<sup>34</sup> See the initial and pioneering contribution on competition in local public goods provision by TIEBOUT (1956).

numerous, and very stringent concerning the goals of lawmakers, the informational requirements, the policy instruments, the distribution of costs and benefits, and more. It appears unlikely that they will all hold in most real world circumstances in which jurisdictions and lawmakers adopt measures and rules.<sup>36</sup>

Second, although the empirical evidence concerning whether the presence of competitive sources of rules and regulations do actually benefit or harm the feasibility of efficient outcomes in the affected population is not unidirectional, some of the most recent evidence, at least in the environmental sphere, should lead us to be even more cautious and less cavalier with respect to the possibility of finding actual cases of races to the bottom that, in the end, are hurtful for social welfare. Whereas the earlier literature on regulatory competition in environmental standards did not find conclusive evidence of an erosion of standards due to regulatory competition,<sup>37</sup> some of the recent evidence seems to point in the opposite direction.<sup>38</sup>

Again, none of this is decisive or entirely carries the day in the debate. Indeed, one should look to further evidence to estimate the empirical relevance of the potentially efficient and inefficient consequences of regulatory competition. Also, new theoretical work may uncover some dimensions that may reveal lower levels of costs or of benefits resulting from regulatory competition.<sup>39</sup>

Thus, the regulatory competition model and its (positive) effects is not something one can generally and unquestionably take for granted.

However, even assuming that regulatory competition works for B2B contracts where parties bargain about the applicable law and the choice of forum clauses, the expansion of choice of legal regime under Art. 6.2 Rome I Regulation is likely not to be warranted.

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<sup>35</sup> See OATES (1972).

<sup>36</sup> For the Tiebout-type of “voting with the feet” –either physically or virtually- models, see WAGNER (2002). For fiscal federalism models, see LEVINSON (2003). In both cases, the contrast between the exacting set of assumptions for regulatory competition leading to optimality, and the likely characteristics of the settings in which lawmakers, however well-intended they may be, have to operate, cast some doubt about the implementability of optimal results through competition of lawmakers and regulators. Of course, the preceding argument does not imply that regulatory competition is inexistent, or is doomed to failure, simply that it is not very likely to be expected in the real world as a mechanism to implement socially optimal outcomes.

<sup>37</sup> See, for instance, LIST and GERKING (2000). Most of this evidence is aptly reviewed, with an eye on the harmonization debate, in FAURE (2003).

<sup>38</sup> See BECKER and HENDERSON (2000); GREENSTONE (2002); FREDRIKSSON and MILLIMET (2002); LEVINSON (2003). For a survey of the recent evidence, see LEVINSON (2008), “pollution haven hypothesis”.

<sup>39</sup> See GANUZA and GOMEZ (2011c), showing how when potential injurers –for instance, firms that may cause harm to consumers, to investors or to the environment- enjoy discretion about the choice of level of assets and may decide to become potentially insolvent, if legal systems use rules that adapt to the actual levels of assets, firms will have less incentive to lower assets, and also will produce lower levels of harm, which in turn means that decentralized choice of rules will be less harmful.

When fully-informed parties bargain about contract terms and governing law, one may perhaps predict that the choice will be welfare-maximizing for the joint situation of both sides. There is no guarantee of this, certainly, even in this scenario. External market factors and the sequence of negotiating the terms (price first, and then governing law and other non-price terms), and differences in bargaining power when there are asymmetries of information between the parties (not concerning knowledge of the law, or the effects of certain legal rules or contract terms, but concerning the underlying parameters of the transaction, such as cost, valuation, magnitude of contingencies and so on) may affect contract design and induce rational parties<sup>40</sup> to choose sub-optimal terms.<sup>41</sup> These distortions may affect also the choice of governing legal regime.

In the typical consumer contract, it is hardly imaginable that consumers will have decent information about the consequences of choosing for the contract a legal regime different from a “familiar” or “expected” regime, such as that of the consumer’s place of residence. Even familiarity with the consumer’s domestic legal order should not be automatically assumed. Even when information about the consequences of one or the other choice is available for the consumer, it is rarely the case that parties to the consumer contract will bargain over such dimension of the transaction. In practice, the choice of legal regime will be a unilateral decision by the firm, buried in the fine print, and consumers would not have known, let alone not “actually” consented to the choice. Even when the consumer has clicked on a box declaring that the consumer has read and understood all the terms, in reality the consumer would not have read, would not have understood, had she read, and had she understood, she would not have been in the position to grasp the entire set of costs and benefits of the choice of a given set of legal rules for the transaction.

Under these conditions, there is no reason to think that the unilateral choice of legal rules will maximize the joint welfare of the parties (absent third party externalities, this is the optimal goal of contract parties and thus of Contract Law). Even if legal systems are sensitive and responsive to the demand by “buyers” of legal rules, and would try to design and implement rules that serve the goals of those “buyers” (as the regulatory competition model predicts), the substantive content of the rules would not be the one maximizing joint contract surplus, since this is not the goal pursued by the party -the firm- who “buys” legal rules from the jurisdictions.

One could possibly ask if the problem is consumers’ lack of information about the alternatives in terms of choice of legal regime, firms may be interested in educating consumers on this respect. For instance, if firm A, who is very much interested in using German Law to serve consumers in other large European markets (France, UK, Italy, Spain, etc.) may be willing to invest resources in educating prospective customers in those markets about the advantages of German Law as a set of rules to govern the transaction. In this way, consumers will be, at the same time, informed

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<sup>40</sup> The argument in the text disregards firms’ myopia about the advantages of different legal regimes and contract terms, or the presence of biases (attachment to the home country legal system) that would further distort the optimal choice of legal regime and contract terms by firms. Thus, the argument in the text is independent and cumulative to behavioural factors as those mentioned in this footnote.

<sup>41</sup> See CHOI and TRIANTIS (2012).

about the importance of the choice of law term, and the substantive benefits of German Law. There are a number of problems concerning this imagined scenario.

First, informing about the content of a legal system is a complex and time consuming task,<sup>42</sup> and given these properties, a likely result would be a high risk of consumer's informational overload.

Second, such information is of a public good (non-rival and non-excludable) nature, and thus the incentives for its provision are suboptimal: if firm A spends resources in educating foreign consumers about choice of law clauses and the relative advantages of German Law, the value from that investment could be reaped also by firm B, C, D, etc. who also cater to similarly situated consumers and also would like to use German Law as a governing law for the contract. Firm A would not be able to charge firms B, C, D, etc. for the benefit they will enjoy of facing better educated consumers about German Law, a benefit that has been obtained through the educational efforts of firm A. The other firms would free ride on firm A's investment, which then makes it unlikely (or less likely, at least) to happen. Again, this does not mean that the level of investment will be necessarily zero, but it will be expected to be below, perhaps far below, the desirable level of educational investment of consumers.

Third, the curse of shrouded attributes is likely to be at work here.<sup>43</sup> Imagine that firm A is using a hidden choice of law clause selecting the legal system of country X, that allows firms to charge undisclosed prices to add-ons or additional services. Imagine that the competitive price for the basic good is 100, and the hidden prices for add-ons would allow the firm to charge 25 for the add-ons, which would be sold competitively at 10. In order to attract customers, firm A offers the basic good at 95, thus looking as a very attractive seller. Consumers that are naïve, would end up paying 120 for a package (basic goods plus the add-ons) whose competitive price is only 110.<sup>44</sup> One would think that A's competitors would have an incentive to inform consumers about what is going on, and tell them that they will sell the basic good at 100 (the competitive price) and that they operate under a different set of rules that forbids undisclosed prices for add-ons. With this information, firm B, say, would expect to attract all customers from firm A. Is this so? The model predicts that this is not going to happen, since that information actually would induce the initially naïve consumers to essentially mimick the sophisticated ones: stick to A for the basic good (at a price of 90 instead of 100, the competitive price) and get the add-ons from other sellers who do not have undisclosed prices for add-ons. Given this expected "clever" reaction by consumers, firm B has nothing to gain from informing naïve consumers, and it will not do so.

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<sup>42</sup> Pointing to the complexities and costliness of informing about the content of national Contract Laws to consumers and, in general, to parties who are not willing and/or able to pay for legal experts, LOW (2013, p. 377); SMITS (2013, p. 59).

<sup>43</sup> For the essential model of shrouding consumers, GABAIX and LAIBSON (2006). An informal presentation of the arguments in GABAIX, LANDIER and THESMAR (2012, p. 13).

<sup>44</sup> Sophisticated consumers, who are able to anticipate the overcharge for add-ons would avoid getting the add-ons from firm A, and would get them from other providers at the competitive price of 10. They will enjoy the package at 100, less than the overall competitive price of 110.

Thus, when consumers will turn “sophisticated” when informed about the consequences of certain excessive prices that can be imposed as a consequence of a certain choice of legal regime, no firm in the market has an incentive to adequately educate consumers, and the choice of legal order intended to exploit consumer naïveté concerning undisclosed features, charges or add-ons, will persist, even if there are many sellers and there is competition in the provision of the goods and services.

Fourth, the incentives of firms to inform consumers about the actual effects of a given choice of laws are systematically biased. Firms would have an incentive to correct pessimistic beliefs of consumers about the consequences of that choice of law (say, for example, choosing German Law) but they will have no incentives to correct wrong beliefs about the legal order when these beliefs are overoptimistic.<sup>45</sup> Assume that foreign consumers’ beliefs about the impact of German Law on the surplus they would obtain from the contract may be wrong or insufficiently informed. Some consumers may be too pessimistic concerning German Law, they may think it ensures them lower surplus than their domestic Law, when this is not the case, because German Law is actually more protective of consumers’ interests than the consumers’ home country Law. Thus, other things being equal, the willingness to pay for the contract of these pessimistic consumers will be lower than it would be, were the consumers in possession of the right information about the impact of both Laws. The firm would have an incentive to educate pessimistic consumers, since this would increase its business. However, there may be also overoptimistic consumers, who hold mistaken positive beliefs about the comparative advantages of German Law for their transaction. Consequently, these consumers are, other things being equal, willing to pay more for the contract under German Law than they would be if their beliefs were the correct ones. Obviously, firms who are able to sell under German Law as a result of the enhanced freedom to choose legal regime in a consumer contract, would have no incentive to correct these false, overoptimistic expectations of foreign consumers.

As a result of these systematic biases, only pessimistic beliefs will be eliminated from the imagination or expectation of consumers, but optimistic beliefs about the effects of contracting under a given foreign legal regime will survive, thus leading to inefficient levels of contracting using that set of rules.

Fifth, given selective and limited consumer attention, relatively esoteric contract terms such as those dealing with choice of legal regime is likely to generate self-confirming incorrect beliefs by consumers,<sup>46</sup> and will be prone to exploitation of limited attention by consumers, given the low salience of the issue.<sup>47</sup>

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<sup>45</sup> AYRES and SCHWARTZ (2013, p. 21).

<sup>46</sup> SCHWARTZSTEIN (2013).

<sup>47</sup> STANGO and ZINMAN (2013).

Sixth, consumers with lower levels of wealth and education are likely to be additionally hurt by a choice of contract terms or a choice of governing rules that allow firms to offer teasing initial prices, but then reduce the value of the transaction through add-ons, reduced warranty coverage that decreases substantially the utility from the good, late payment fees, and similar features that may be possible under certain legal regimes but not others. As has been recently shown,<sup>48</sup> consumers with scarce resources are more likely to focus only on savings in the front price for the contract, and disregard, perhaps completely, later consequences. Thus, if the choice of a given governing law allows the firm to obtain extra surplus from the contract (through late fees, or reduced production and after sales costs due to the limited warranty) that permit an aggressive up-front price, this is likely to be appealing to firms that currently interact with consumers of modest means, since they will disproportionately focus on the immediate savings, and thus will find the contract disproportionately more attractive.

If we go back to Art. 6.2 Rome I Regulation what we find if we understand the provision functionally is the introduction of a flexible floor to the “basic legal quality” of the contract by allowing choice of law provisions, but subject to the constraint of the mandatory protective rules of the legal system of the consumer’s habitual residence. At first blush (although we will come later to this point) the set of rules of the consumer’s home legal system are the ones with which the consumer is likely to be more familiarized, and thus, is likely to become the best guess –without incurring in the costly exercise of actually knowing the what the actual consumers’ expectations about the outcome of the contract are– concerning the average consumer’s expectation about the basic legal quality of the contract.

In consumer markets, the introduction of minimum quality levels concerning the transaction has been subject to an extensive literature. The earlier papers identified a negative impact upon consumers with the lowest willingness to pay for quality.<sup>49</sup>

The recent literature is notably more positive about the introduction of such “quality floors”. In the most important paper in this literature,<sup>50</sup> it is shown that the introduction of adequately chosen “quality floors” may improve welfare when there is vertical competition between producers of different levels of quality, and where the costs for the firms do not rise too steeply with quality (as is likely the case with choice of governing law clauses, that typically do not fundamentally affect the production technologies of firms, although they may have important impact). A reasonable quality floor would increase the degree of vertical competition due to the reduced quality space, and firms will raise quality, but quality-adjusted prices would not rise. As a consequence, more consumers will buy the good after the minimum legal quality is introduced, and at better legal quality-adjusted prices. It is important to mention that the model predicts that no consumers are made worse-off, even those with lower willingness to pay for legal quality.

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<sup>48</sup> MULLAINATHAN and SHAFIR (2013, p. 19).

<sup>49</sup> LELAND (1979); SHAPIRO (1983).

<sup>50</sup> RONNEN (1991).

These basic ideas have been extended<sup>51</sup> to an imperfect information setting, and to scenarios allowing low for both horizontal and vertical competition, and find that the quality floors increase equilibrium qualities, as well as firms' profit and total welfare, and under plausible assumptions about the imperfect information, consumer welfare undeniably increases.

These advantages from "basic legal quality floors" arise from increased vertical competition in consumer markets. Thus, when increased competition would not help, the positive effects would not be present. Notice that competition may not always help consumers and may in fact be hurtful to them. For instance, it has been recently shown<sup>52</sup> that when firms face two types of consumers, sophisticated and naïve, were the former would suffer less than the latter from an inefficient or oppressive contract term (including a choice of law clause), increased competition would induce firms to use more one-sided and inefficient (for joint surplus) terms, because enhanced competition would reduce their profit from sophisticated consumers, and thus they are more willing to resort to increased exploitation of the naïve customers. Thus, in this setting, firms have a larger incentive to introduce undesirable clauses when there is more effective competition in the market, of when they can easily separate the two types of consumers by offering a menu of differentiated contracts. Thus, the more vulnerable consumers may expect a fairer treatment from a monopolist who is in the position of exploiting the sophisticated consumers more fully.

The above findings imply that it is not easy to draw quick policy implications from the stock of economic knowledge on these matters. Thus, it seems at best premature to advocate lifting the constraints on selection of governing law currently in force under Art. 6.2 Rome I Regulation.

One could argue that if the constraints are removed, but the choice is limited to EU national legal systems, there will be an implicit floor provided by the minimum level of consumer protection set by the EU consumer Directives. That national legal systems have to comply with the minimum requirements of the minimum harmonization Directives is of course true, and thus the "basic legal quality" cannot go to zero if one restricts choice to EU Member States national legal systems.

Still, if one thinks (as we do) that the expectations of the average consumer are important to set the floor, it may be best to continue using the benchmark of the consumer's home country laws and not the minimum common denominator of the EU Consumer Directives. Although the knowledge by consumers of the basic legal quality under their national Law is likely to be rough at best, we conjecture that in expectation is highly probable to be much more precise than knowledge about the content of the minimum harmonization Directives. Preserving the current Rome I Regulation benchmark, it is however possible to increase choice of governing law in a way that is much less likely to harm consumers, while eventually being able to generate the

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<sup>51</sup> GARELLA and PETRAKIS (2008).

<sup>52</sup> FRIEDMAN (2013).

alleged cost savings for firms associated with the choice of their own national law also in cross-border trade.

The proposal would be as follows:<sup>53</sup> The starting point is the same as in Art. 6.2 Rome I Regulation, that is, choice of governing law is feasible in consumer contracts, but the outcome cannot deprive the consumer of the mandatory protection of the Law of its domicile (the one with respect to which she is more likely to hold more accurate, or less inaccurate, expectations). However (and here comes the expanded choice of law), the solution of the chosen governing law, even if it is less protective of the consumer than the corresponding one in the consumer's national law, would apply if the difference between the two had been clearly and expressly disclosed and adequately explained in the contract. A vague and general reference in standard terms buried in fine print or screens away from the consumer. In fact, some kind of standardized<sup>54</sup> (in dimension, location in the contract, appearance, language) and attention-calling warning should be inserted in the contract, so as to minimize the chances that consumers do not read, or do not become reflectively aware of the departure from the more protective solution in the consumer's home law.

We are not fundamentally against exploring the possibilities of expanded choice (be it through the choice of CESL or the choice of national legal orders) as to governing law in consumer contracts. But many unknowns are yet to be dispelled before we can safely adopt major changes. A more incremental approach, that is both cautious and economically informed, is likely to generate higher social benefits.

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<sup>53</sup> The proposal resembles that of AYRES and SCHWARTZ (2013, p. 34), in the national context, concerning terms unexpected by consumers as evidenced by actual consumer surveys.

<sup>54</sup> For a possible example of such standardized warnings, see AYRES and SCHWARTZ (2013, p. 54).

## 6. *Conclusions*

Recent developments in European Law have restored importance to issues of legal regime and choice in consumer contracts. The debates already under way are likely to be with us for some time. We think that bringing Law and Economics views to them will be helpful to assess the merits of the claims that have been made, and to illuminate the consequences of different options. Deploying a Law and Economics approach, and making use of previous work of ours on the area, we have analyzed three distinct issues concerning governing law and choice in consumer contracts: the undesirability of almost any choice, and especially that of a European transnational set of rules; the ineffectiveness of choice regarding a new legal instrument governing consumer contracts; the insufficiency of current levels of choice of law and the need to lift the current restrictions to choice of law contained in Rome I Regulation.

Our view is that, seen through economic lenses, those three claims present significant flaws. Our view of choice in this area is neither wholly pessimistic nor overtly optimistic. Many things can go wrong, but many are apt to work, too. We advance a modest proposal that, preserving the benchmark of Art. 6.2 Rome I Regulation, may allow some degree of expanded choice as to legal regime in consumer contracts.

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